

Message Text

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FM AMEMBASSY ADDIS ABABA

TO SECSTATE WASHDC 4181

INFO AMCONSUL ASMARA

AMEMBASSY KHARTOUM

AMEMBASSY LONDON

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AMEMBASSY NAIROBI

AMEMBASSY PARIS

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E.O. 11652: N/A

TAGS: EGEN ET

SUBJECT: ETHIOPIAN ECONOMIC SITUATION

REF: ADDIS 15318

1. BEGIN SUMMARY. ALTHOUGH ETHIOPIA HAS PROBABLY JUST EXPERIENCED THE BEST CEREAL CROP IN RECENT YEARS, THE OUTLOOK FOR ETHIOPIAN AGRICULTURALISTS IS CLOUDED BY UNCERTAINTIES RESULTING FROM LAND REFORM AND LOW WORLD PRICES FOR ETHIOPIA'S PRINCIPAL EXPORT CROPS. MANUFACTURING OUTPUT FELL TWO TO THREE PERCENT DURING THE FIRST PART OF THIS YEAR. WITH BOTH THE EPMG AND THE MUNICIPALITY OF ADDIS MAKING STRONG EFFORTS TO FUND NEW PROJECTS AND THEREBY IMPROVE EMPLOYMENT, THE OUTLOOK FOR THE CONSTRUCTION INDUSTRY HAS BRIGHTENED CONSIDERABLY. EMPLOYMENT HAS GENERALLY HELD STEADY, ALTHOUGH SMALL GROUPS OF DISSIDENT EMPLOYEES HAVE BEEN CAUSING LABOR UNREST IN A NUMBER OF FIRMS. COMPARED TO THE SAME PERIOD OF LAST YEAR,

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BUSINESS TURNOVER IN RETAIL TRADE IS DOWN BY ANYWHERE FROM 10 TO

15 PERCENT. UNCERTAINTY AND FEAR OF FURTHER NATIONALIZATION ARE INHIBITING ACTUAL IMPORTS OF ORDERED GOODS AND THE PORTS OF ASSAB AND DJIBOUTI ARE BECOMING MORE AND MORE CONGESTED, ALTHOUGH THIS IS USUALLY THE BUSIEST SEASON FOR THE PORTS. FOREIGN SUPPLIERS ARE INSISTING ON IRREVOCABLE LETTERS OF CREDIT AND IN THE WAKE OF LAND REFORM, MANY OF ETHIOPIA'S LEADING TRADING COMPANIES HAVE BEEN LEFT HOLDING LARGE AMOUNTS OF DEBTS. PRIVATE CREDIT DEMAND HAS DROPPED, DEPOSIT WITHDRAWALS ARE OUTRUNNING NEW DEPOSITS AND COMMERCIAL BANKS ARE NOW FACING A LIQUIDITY PROBLEM. PRIVATE INVESTMENT ACTIVITY IS VIRTUALLY ZERO. ETHIOPIA'S NET FOREIGN EXCHANGE POSITION FELL FROM ETH\$613 MILLION LAST DECEMBER TO ETH\$591 MILLION AT THE END OF MARCH, LARGELY AS THE RESULT OF LOWER PRICES FOR ETHIOPIAN EXPORTS. END SUMMARY.

2. AGRICULTURE

IT NOW APPEARS THAT THE CEREAL CROP JUST HARVESTED MAY BE THE BEST IN RECENT YEARS. THIS IS CLEARLY FORTUITOUS AS THE OUTLOOK FOR ETHIOPIAN PRODUCTION FOR THE SEASON BEGINNING THIS SUMMER IS CLOUDED BY UNCERTAINTIES RESULTING FROM THE LAND REFORM PROGRAM PROCLAIMED ON MARCH 4. WITH RESPECT TO AGRICULTURAL COMMODITIES RAISED PRIMARILY FOR EXPORT, BOTH LAND REFORM AND CURRENT LOW WORLD PRICES MAY ALSO HAVE AN ADVERSE EFFECT ON PRODUCTION OF THESE CROPS. COFFEE PRICES, FOR EXAMPLE, HAVE FALLEN FROM 59 CENTS PER POUND EARLIER THIS YEAR TO 39 CENTS (FOB DJIBOUTI) AND IT IS LIKELY THAT COFFEE PRICES WILL REMAIN LOW FOR THE BALANCE OF THE YEAR. HARICOT BEAN PRICES ARE ALSO VERY LOW AS ARE THOSE FOR HIDES AND SKINS. THESE LOW PRICES MAY BE SOMEWHAT OFFSET BY INCREASES IN THE VOLUME OF COFFEE AND HARICOT BEANS EXPORTS AS COMPARED WITH LAST YEAR. BUT CURRENTLY THE GOVERNMENT IS REFUSING TO LET EXPORTERS SHIP EITHER COMMODITY AS THE PRICES ARE CONSIDERED TO BE TOO LOW. THE GOVERNMENT ALSO HOPES TO INCREASE EXPORTS OF THESE AND OTHER COMMODITIES TO EASTERN EUROPEAN COUNTRIES AND MAINLAND CHINA. TRADE CIRCLES, HOWEVER, ARE HIGHLY SKEPTICAL ABOUT PROSPECTS IN THESE MARKETS. ON THE BRIGHTER SIDE, SESAME SEED EXPORTS WERE QUITE GOOD THIS SEASON AND EXPORTS OF SUGAR AND COTTON ARE PROBABLY EXCEEDING LAST YEAR'S LEVEL. ACCORDING TO RELIABLE SOURCE, SUGAR EXPORTS MAY DOUBLE FROM 15,000 TONS TO 30,000 TONS. BUT THESE EXPORTS ARE STILL A VERY SMALL PART OF TOTAL ETHIOPIAN EXPORTS. THE EXPORT SURTAX WHICH WAS INTRODUCED A FEW WEEKS AGO HAS HAD PRACTICALLY NO IMPACT ON LIMITED OFFICIAL USE

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EXPORTS AS THE PRICES CURRENTLY PREVAILING IN THE INTERNATIONAL MARKET ARE GENERALLY BELOW THE THRESHOLD PRICES AT WHICH THE SURTAX TAKES EFFECT.

3. MANUFACTURING, CONSTRUCTION AND EMPLOYMENT

A. MANUFACTURING OUTPUT, WHICH IN 1974 WAS ABOUT THE SAME AS 1973 LEVELS, REPORTEDLY DROPPED BY 2-3 PERCENT OVER THE FIRST FEW MONTHS OF 1975. THIS APPEARS TO BE CONFIRMED BY A DROP IN

CONSUMPTION OF ELECTRICITY OF ABOUT 5 PERCENT DURING JANUARY AND FEBRUARY. BECAUSE OF UNPRECEDENTED DEMAND, TEXTILE PLANTS HAVE BEEN RUNNING AT FULL CAPACITY, ALTHOUGH WORKER EFFICIENCY HAS ALLEGEDLY DROPPED SOMEWHAT SINCE NATIONALIZATION OF THIS SECTOR. IN MID-APRIL, THE GOVERNMENT STATED THAT PRODUCTION AT ALL NATIONALIZED ENTERPRISES HAD INCREASED BY 20 PERCENT, BUT THIS IS ALMOST CERTAINLY INCORRECT. THERE IS A GOOD POSSIBILITY, HOWEVER, THAT PRODUCTION OF BEER AND SOFT DRINKS CONTINUE TO RISE. LAST MONTH FIAT BEGAN ASSEMBLING 180 HP TRUCKS AND LAND ROVER FOUR-WHEEL DRIVE VEHICLES. THIS IS THE ONLY MAJOR NEW INDUSTRIAL UNDERTAKING TO HAVE COME ON STREAM DURING THE PAST YEAR. THE PLANT WAS ORIGINALLY SCHEDULED TO GO INTO PRODUCTION OVER A YEAR AGO, BUT WAS HELD UP BECAUSE OF A TAX DISPUTE; THE ITALIAN INTERESTS FINALLY ACQUIESCED THEREBY ALLOWING ASSEMBLY TO BEGIN.

B. BOTH THE EPMG AND THE MUNICIPALITY OF ADDIS ABABA HAVE BEEN MAKING STRONG EFFORTS TO INCREASE EMPLOYMENT. THE EPMG, FOR EXAMPLE, RECENTLY AUTHORIZED ETH\$11 MILLION (US\$5.4 MILLION) FOR ROAD IMPROVEMENTS IN ADDIS (ALREADY UNDER WAY), PROVIDING EMPLOYMENT FOR APPROXIMATELY 2,000 WORKERS. ANOTHER 9,000 OR SO ARE EMPLOYED ON AN IBRD-FUNDED MUNICIPAL SEWERAGE PROJECT. OTHER NEW PROJECTS INCLUDE PUBLIC HOUSING, SCHOOLS, AND GOVERNMENT BUILDINGS. ACCORDING TO THE COUNTRY'S LARGEST BUILDING CONTRACTOR, THE INDUSTRY IS NEVERTHELESS CONCERNED ABOUT THE UNIONS' CONTINUED DEMAND FOR A ETH\$3/DAY MINIMUM WAGE FOR UNSKILLED LABORERS (CURRENTLY ETH\$1/DAY) AND THE SPECTER OF NATIONALIZATION. GENERALLY SPEAKING, HOWEVER, THE OUTLOOK FOR THIS SECTOR IS BRIGHTER THAN IT HAS BEEN IN A LONG TIME.

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C. DESPITE A SLOWDOWN IN BUSINESS AND PRODUCTION, EMPLOYMENT IN COMMERCIAL UNDERTAKINGS AND MOST FACTORIES HAS HELD STEADY. AS A RESULT OF THE GOVERNMENT'S PROHIBITING MOST EMPLOYERS FROM FIRING WORKERS, LAYOFFS ARE RARE EXCEPT FOR THE UNSKILLED, AND THESE HAVE BEEN ABSORBED IN THE PUBLIC WORKS PROJECTS MENTIONED ABOVE. MANY NATIONALIZED INDUSTRIES SEEM TO BE SUFFERING FROM LABOR TROUBLES OF ONE KIND OR ANOTHER, LARGELY AS THE RESULT OF A CHANGE OF MANAGEMENT AND LACK OF LEADERSHIP. IN A RATHER OMINOUS DEVELOPMENT, THE PMAC NOW INTERVENES IN THESE DISPUTES TO A GREATER EXTENT THAN PREVIOUSLY. WITHIN THE PAST FEW WEEKS, FOR EXAMPLE, SMALL GROUPS OF DISAFFECTED EMPLOYEES OF THE HILTON HOTEL AND EAL HAVE COMPLAINED TO THE PMAC WHICH HAS RESULTED IN THE DISMISSAL OF EAL'S GENERAL MANAGER AND A WEAKENING OF MANAGEMENT CONTROL AT THE HILTON. THIS TREND, IF IT CONTINUES, COULD SERIOUSLY JEOPARDIZE THE EFFICIENT OPERATION OF MAJOR BUSINESS ENTERPRISES.

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4. RETAIL TRADE AND PRICE TRENDS

A. COMPARED TO THE SAME PERIOD LAST YEAR, BUSINESS TURNOVER IS GENERALLY DOWN BY ANYWHERE FROM 10 TO 50 PERCENT, DEPENDING ON THE TYPE OF PRODUCT. CONSUMERS HAVE TO PAY CASH, AND MAY WELL PREFER TO DO SO, EVEN FOR LARGER PURCHASES. OWING TO FEAR OF DEVALUATION, SALES OF CONSUMER DURABLES ARE MOVING WELL; FOR EXAMPLE, PASSENGER CARS UNDER 1300 CC'S ARE SELLING BRISKLY COMPARED TO THE END OF LAST YEAR. UNCERTAINTY AND FEAR OF FURTHER NATIONALIZATION, PARTICULARLY OF THE IMPORT-EXPORT AND THE WHOLESALE SECTORS, ARE INHIBITING IMPORTS AND THE PORTS OF ASSAB AND DJIBOUTI ARE BECOMING MORE AND MORE CONGESTED AS IMPORTERS ARE RELUCTANT TO TAKE POSSESSION OF THEIR GOODS AND MOVE THEM TO ADDIS. TO ALLEVIATE THE SITUATION, THE EPMG RECENTLY ORDERED TRUCKS TO THE PORT (200 RECENTLY ARRIVED IN ASSAB, ACCORDING TO PORT AUTHORITIES) AND INSTRUCTED IMPORTERS TO SEE THAT THEIR COMMODITIES MOVE MORE RAPIDLY TO THE CAPITAL. PORT CONGESTION THIS TIME OF YEAR IS NOT UNCOMMON, HOWEVER, AND A LARGE CONSIGNMENT OF FERTILIZER HAS EXACERBATED THE SITUATION.

B. BECAUSE OF THE ADVERSE PUBLICITY ETHIOPIA HAS RECEIVED IN THE WORLD PRESS, FOREIGN SUPPLIERS' CREDITS HAVE VIRTUALLY CEASED AND MOST OVERSEAS SUPPLIERS, INCLUDING THE EASTERN EUROPEANS, ARE

ASKING EVEN OLD-ESTABLISHED CUSTOMERS FOR IRREVOCABLE LETTERS OF CREDIT GUARANTEED BY NEW YORK BANKS. MOREOVER, IN THE WAKE OF LAND REFORM, MANY OF THE LARGEST TRADING COMPANIES HAVE BEEN CAUGHT HOLDING LARGE AMOUNTS OF UNCOLLECTIBLES ON FARM MACHINERY. ELEVEN COMPANIES HOLDING ETH\$8 MILLION IN SUCH OUTSTANDINGS RECENTLY APPROACHED THE "DIRG" WHO PROMISED THEY WOULD LOOK INTO THE MATTER. THE BUSINESS COMMUNITY HAS OVER THE PAST MONTHS HELD A NUMBER OF MEETINGS WITH THE GOVERNMENT ON BUSINESS CONDITIONS, BUT DOES NOT SEEM TO HAVE GAINED MUCH SATISFACTION. AS A RESULT, A "CREDIBILITY GAP", IN THE WORDS OF A CHAMBER OF COMMERCE OFFICIAL, HAS ARISEN BETWEEN THE BUSINESS COMMUNITY AND GOVERNMENT AND APPEARS TO BE GROWING. UNTIL THE GOVERNMENT CLARIFIES ITS INTENTIONS TOWARD THE PRIVATE SECTOR AND ISSUES ITS LONG PROMISED INVESTMENT CODE, BUSINESS CONFIDENCE AND MORALE WILL REMAIN SERIOUSLY DEPRESSED.

C. PRICE TRENDS CONTINUE TO BE DISTORTED BY PRICE CONTROLS WHICH HAVE BEEN EXTENDED TO NUMEROUS RETAIL COMMODITIES. ALTHOUGH THE GOVERNMENT HAS NOT STRINGENTLY ENFORCED THESE CONTROLS AND THE MARKET IS AGAIN PLAYING A ROLE IN PRICE DETERMINATION, PARTICULARLY FOR AGRICULTURAL COMMODITIES, IT IS NEVERTHELESS VERY HARD TO DETERMINE CURRENT PRICE BEHAVIOR OR TO DISCERN FUTURE TRENDS.

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5. BANKING AND INVESTMENT

ETHIOPIA'S MONETARY SITUATION HAS CHANGED SUBSTANTIALLY IN RECENT MONTHS. DEPRESSED WORLD PRICES FOR ETHIOPIAN EXPORTS, UNSETTLED DOMESTIC BUSINESS CONDITIONS AND LAND REFORM HAVE ALL REDUCED PRIVATE CREDIT DEMAND. CONCURRENTLY, TIME AND SAVINGS DEPOSIT WITHDRAWALS HAVE REDUCED THE COMMERCIAL BANKS' ASSET BASE. ACCORDING TO A SENIOR COMMERCIAL BANK OFFICIAL, THE RATION OF WITHDRAWALS TO DEPOSITS, WHICH NORMALLY RUNS AT 1 TO 5, IS NOW 11 TO 10. THE JANUARY BANK NATIONALIZATIONS AND FEARS OF GOVERNMENT CONFISCATION OF BANK DEPOSITS ABOVE A CERTAIN LIMIT MAY HAVE LED TO THESE WITHDRAWALS. AS A RESULT, THE COMMERCIAL BANKS ARE NOW FACING A LIQUIDITY PROBLEM. INVESTMENT ACTIVITY HAS REACHED ROCK-BOTTOM, WITH VIRTUALLY NO NEW PRIVATE INVESTMENT ACTIVITY. BUSINESS CONFIDENCE, AS NOTED ABOVE, MUST BE RESTORED BEFORE ANY CHANGE CAN BE EXPECTED.

6. EXTERNAL SECTOR

ETHIOPIA'S NET FOREIGN EXCHANGE POSITION STOOD AT ETH\$591 MILLION AT THE END OF MARCH, COMPARED TO ABOUT ETH\$613 MILLION LAST DECEMBER. A MAJOR FACTOR IN THIS DOWNTURN IS THE FAILURE OF ETHIOPIA'S MAJOR COMMODITY EXPORTS TO MAINTAIN SUFFICIENT VOLUMES TO COMPENSATE FOR LOW WORLD COMMODITY PRICES. AT THE SAME TIME, IMPORTS HAVE BEEN RUNNING AT LAST YEAR'S LEVELS, THE NATIONAL BANK IS FORCING THE COMMERCIAL BANKS TO UTILIZE THEIR PREVIOUSLY EXTENSIVE FOREIGN EXCHANGE HOLDINGS TO FUND IMPORTS WHICH HAS RESULTED IN A FALL OF COMMERCIAL BANK NET FOREIGN

EXCHANGE HOLDINGS FROM ETH\$175 IN NOVEMBER TO ABOUT ETH\$52 MILLION IN LATE MARCH.

7. COMMENT. WHILE IT IS STILL TOO SOON TO DETERMINE THE EFFECTS OF NATIONALIZATION AND LAND REFORM, THERE IS SOME EVIDENCE THAT THE ECONOMY IS BEGINNING TO SLOW DOWN. ON THE OTHER HAND, MOST OF THE EXPROPRIATED BUSINESS FIRMS AND COMMERCIAL FARMS WERE IN HEALTHY FINANCIAL CONDITION AT THE TIME OF THEIR TAKEOVER, WHICH SHOULD HELP THEM WEATHER INITIAL DIFFICULTIES ASSOCIATED WITH THEIR TRANSITION FROM PRIVATE TO PUBLIC ENTERPRISES. WITH RESPECT TO THE PRIVATE SECTOR, THE GOVERNMENT'S MOST PRESSING REQUIREMENT IS TO RESTORE THE CONFIDENCE OF THE BUSINESS COMMUNITY BY BOTH WORD (E.G., DECLARATION ON INVESTMENT POLICY) AND DEED (E.G., SUPPORT IN LIMITED OFFICIAL USE

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LABOR/MANAGEMENT DISPUTES). UNTIL THIS IS DONE, THE PRIVATE SECTOR'S CONTRIBUTION TO ECONOMIC GROWTH WILL PROBABLY BE NIL. HUMMEL

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